ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

MENA-OECD INVESTMENT PROGRAMME

Toward a Strategic Framework on Infrastructure Financing

Key Recommendations to the Government of Iraq

2nd Meeting of the Working Group on Infrastructure Finance in Iraq
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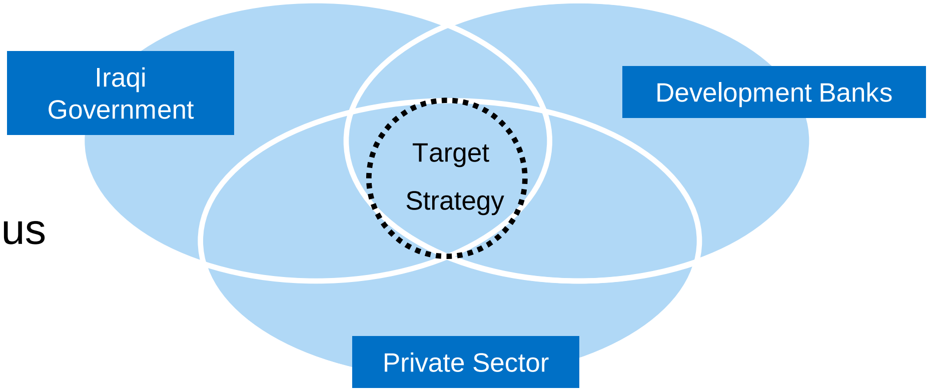
Thinking about Sources of Finance



Iraqi government

- Limited government budgets
- Full privatisation of state assets contentious
- Uncertain timeframe for oil revenues

International financial institutions

- World Bank, Islamic Development Bank, etc. already present in country and increasing involvement
- Strong fit for infrastructure provision given experience in post-conflict areas
- However: pre-determined budgets – only certain projects will receive support in certain years

Private Sector

- **Largest remaining untapped source of funds**
- However: high sensitivity to perceived risks of doing business in Iraq

Accessing Private Sector Funds

What are the key factors to consider in designing an infrastructure strategy that taps the private sector?

Section 1	Private sector motivations and evaluation criteria – perception of risk
Section 2	Legislative and regulatory frameworks to balance risk mitigation and public interest
Section 3	Selection of means with which to involve private sector
Section 4	Selection of projects likely to appeal to private sector

Private Sector Point of View

Section 1

How might a private sector company approach an opportunity in Iraq?

Go/No Go Issues	• Security: safety of employees
High Concern	• Security: ability to operate without external disruptions • Contract validity (especially with new governments) and enforcement (legal mechanisms) • Expropriation • Capital transfer • Transparency of procurement decision and award processes
Standard Concern	• Likely return on investment • Future opportunities in country • Company's comfort with type of project, operating environment, and skill requirements

Sector Differences Matter

Section 1

- Perceptions of risk vary strongly by sector
- Some sectors – oil and minerals, especially – are used to challenging political environments and post-conflict zones
- Infrastructure providers –outside the scope of extractive projects – are typically more fearful and risk-averse

Government Framework for Mitigating Risk

Section 2

- Government can mitigate many infrastructure risks perceived by investors
- Certain risks may be beyond reach (e.g., security), but government can consider indirect solutions (e.g., incentives)

Perceived Risk	**Government Action**
Security and Political Risks	Enabling involvement of guarantee agencies Incentives
Contract Validity and Enforcement	Clear contract terms PPP law BITs/ICSID/NY Convention
Expropriation and Capital Movement	Explicit investment law and referral to dispute resolution mechanisms in contracts and BITs
Transparency	Clear procedures Clear contract terms Dispute resolution mechanisms

Enabling Guarantee Agency Involvement

- Guarantee agencies are a crucial ally for post-conflict governments looking to involve the private sector in infrastructure projects
- Risk insurance (especially for political risk) for investors provides third-party source of mitigation not available through commercial banks
- **Investor must have significant role or stake in project**
- **Many guarantee agencies require investment treaties between home country and investment country**

Enabling Guarantee Agency Involvement

Section 2: Mitigating Risk

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Major Guarantee Agencies

Example: Types of MIGA coverage for equity, lenders, and other investors

- Inconvertibility and Transfer Risk
  - Inability to convert local currency into hard currency and repatriate
- Political Violence Risk
  - Losses from war, revolution, insurrection, sabotage, and terrorism
- Expropriation Risk
  - Losses from expropriation, nationalization, or confiscation by a foreign government, creeping expropriation
- Breach of Contract, Government Non-payment
  - Protection against sovereign or parastatal defaults

Source: MIGA

BITs and Arbitration

Perceived risk around contracts (validity and enforcement) is often mitigated by signing international conventions and bilateral investment treaties:

- BITs provide for investor protection provisions, including dispute settlement mechanism
- BITs may also allow investors to apply for insurance from guarantee agencies
- ICSID assures investors that disputes will be resolved according to transparent and predictable rules – especially important in countries with recently formed or post-conflict judicial systems and few legal precedents
- The New York Convention (144 members) ensures that arbitral awards are recognised and enforced
- Many MENA countries are already signatories, such as:

  ICSID: Algeria, Bahrain, Egypt, Jordan, Kuwait, Lebanon, Morocco, Oman, Saudi Arabia, Syria, Tunisia, UAE, Yemen

  NYC: Algeria, Bahrain, Djibouti, Egypt, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia
- Other arbitration venues: Stockholm Chamber of Commerce, International Chamber of Commerce (Paris), ad hoc (parties set up tribunal on their own and use UN Commission on International Trade (UNCITRAL) rules

Transparency in Procurement and Contracts

Private sector investors will want assurance that they will be fairly considered for project participation and fairly treated if selected. GoI and MENA-OECD have already completed extensive stocktaking of public-private challenges, as well as best practices to encourage private funding, among them:

- Set clear, detailed, and publicly available criteria and procedure for selection of private companies in infrastructure projects
  - Limit revision of procedures – get it right the first time
  - Include concrete dates for decision process
- Describe expected contract performance in detail – deliverables, quality, and timeline
- Set and describe dispute resolution means related to contract performance
- Establish Code of Conduct and require associated training for government staff
- Enable internal and external auditing of contract award and execution

Using Incentives

Section 2: Mitigating Risk

- Tax and customs incentives are used widely in the OECD and MENA regions to unlock private funds
- Provided for in the Iraqi Investment Law
- Incentives can compensate for otherwise low return rates or feelings of insecurity
- However: incentives rank lower in importance to investors than, for example, political and economic stability, market access, competitive cost structures, and an attractive business environment
  - Good mitigation and complement, but not a solution

- Incentives also require very careful deployment: identification of best use, robust cost-benefit analysis, and regular review

Vehicles of Private Sector Involvement

Section 3

Option	Asset ownership	Operation and maintenance	Capital investment	Commercial risk	Duration (years)
Service contract	Public	Public and private	Public	Public	1–2
Management contract	Public	Private	Public	Public	3–5
Lease	Public	Private	Public	Shared	8–15
Build-operate-own (BOO)	Private (bulk services)	Private	Private	Private	20–30
Concession	Public	Private	Private	Private	25–30
Privatisation	Private	Private	Private	Private	Indefinite

Source: Cohen, Shams, Attia, 2002

Implementing PPPs

Section 3

Legal Framework

- Public-private partnerships (PPPs) are typically enabled by specific legislation allowing shared public and private control over aspects of state-owned assets
- Law must:
  - Define types of allowable PPPs
  - Specify contracting authorities, criteria for private sector participation, and procedures for project governance and review
  - Create sectoral or economy-wide boundaries

PPP Management

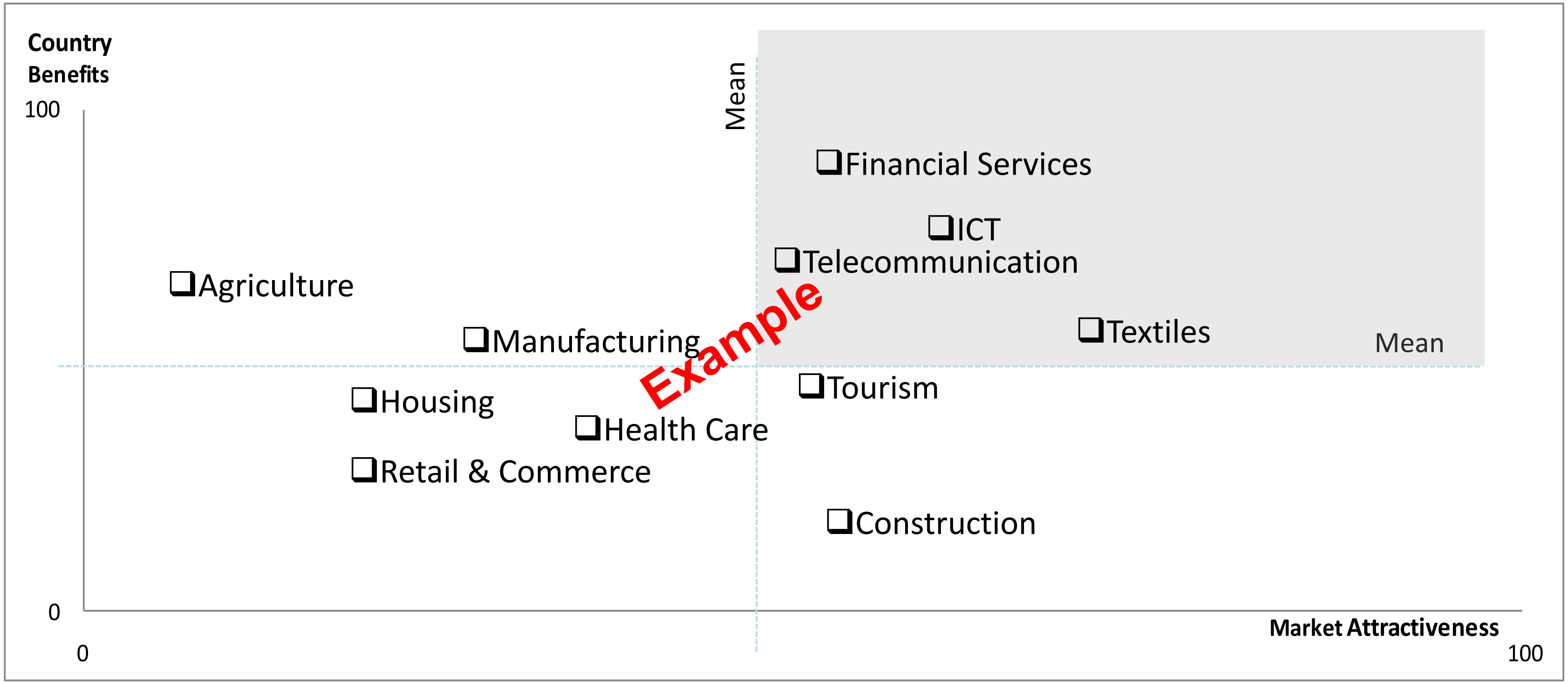
- PPP units are created in response to limitations in governments' ability to manage a PPP programme effectively
- Successful examples of PPP units:
  - Have staff with capacity to manage commercial processes and mix of expertise
  - Are attached to cross-sectoral ministry (treasury or finance ministry)
  - Have high-level political support

Setting Realistic Expectations

- Private sector involvement is not a case of “ask and you shall receive”
- If private companies do not think they can succeed or make a profit, they will not invest funds into infrastructure projects
- Governments must continually consider:
    - Returns desired by companies and likelihood of achieving those returns
    - Level of risk that each **sector** might be willing to accept – few investment areas are as attractive as extractive industry
    - Ability of company to deliver objectives based on operating conditions
- If government cannot foresee success from private sector point of view, then project is probably not appropriate for private involvement

Targeting the Right Sectors

Section 4



Sectors should appeal to investors while delivering public interest benefits.

Selecting the Right Projects

Section 4

- At the **1st meeting of the Working Group on Infrastructure Finance**, members called on the OECD Secretariat to prioritize a selection of future infrastructure projects

- The priority order of the suggested projects was to be determined on the basis of a list of criteria:

  - **development strategy;**
  - **priority sector;**
  - **basic services;**
  - **social and environmental impact;**
  - **trade facilitation;**
  - **technology transfer; and**
  - **return on investment.**

Selecting the Right Projects

Section 4

Development strategy

- Presence or absence of a given project in the draft Iraq National Development Plan (NDP) 2010-2014.
- All-or-nothing grade: a project scores 10/10 if it is mentioned in the National Development Plan and 0/10 if it is not.

Priority sector

- The extent to which a project corresponds to a sector that is of immediate importance to Iraqi reconstruction, growth and jobs.
- For example, highways, ports and oil-related projects are considered high priority because of the export revenue they can generate and role in getting goods to market.
- Flow-on effects in terms of employment, growth, and purchasing power for further reconstruction should be considerable, so projects in such sectors are rated highly.
- A waste recycling project, although laudable in terms of sustainable development, would not be expected to have the same growth and jobs impact, and therefore receives a lower score.

Selecting the Right Projects

Basic services

- Role of the project in the provision of basic services (e.g. water, electricity, etc.)
- Examples:
  - Slaughterhouses = 7 (contribution to hygiene in meat production);
  - date processing = 0 (not directly related to basic needs).

Social and environmental impact

- Contribution of a project to positive social impacts or positive environmental impacts
- Job creation is not included in this criterion because it is measured as part of the priority sector criterion.
- 5 points out of 10 were allocated to social impact and 5 to environmental impact.
- Only the housing project in Falluja obtained any points for the social impact sub-score.
- A high environmental impact score was more common, and was attributed to clean energy projects, waste treatment and recycling, and rail transport (assuming electrification).

Selecting the Right Projects

Section 4

Trade facilitation

- Contribution of each project to various forms of trade facilitation (improved transport for export, better adherence to standards, reinforcement of Iraqi product visibility in overseas markets).
- Oil and port infrastructure draws high grades due to the extreme importance of hydrocarbons in Iraqi foreign trade.
- Sewerage and housing projects score poorly.

Technology transfer

- Role of each project in encouraging technology transfer and the acquisition of international know-how by Iraq.
- Projects generating the transfer of relatively complex or innovative technology are scored more highly (port infrastructure and renewable energy).
- Projects that bring well-established or less complex technology (electricity generation facilities and highways) receive modest scores.

Return on investment

- Annualised rate of return on the total investment over the life of the project, based on cash-flow forecasts.
- Scores for this criterion have not been calculated since the necessary detailed cash-flow projections for the various projects are not available.

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Calculating the Weighted Average

Criteria	Weight
Priority sector	3
Basic services	3
Return on investment	3 (not scored)
Development strategy	2
Social and environmental impact	2
Trade facilitation	1
Technology transfer	1

The overall ranking of projects is on the basis of a **weighted average** reflecting the fact that certain criteria are regarded as being of **greater importance** than others.

Each criterion is assigned a weight of 1, 2 or 3, with 3 being the heaviest weight.

Interpretation of the Results

- Result: a ranked list of priority infrastructure projects based on the criteria outlined above.
- These criteria reflect benefits for Iraq and private investors and not necessarily the screening requirements of international financial institutions.
- So, the highest ranked projects will not in every case be the best candidates for international loans or private investment and related guaranties.

The **six projects selected** for case studies at this meeting are not all among the top six projects in terms of the priority ranking.

The **Falluja housing project**, the **renewable energy project**, and the **railways project** outrank several of the case study projects, but may not closely match the screening profile of international financial institutions or investors in terms of potential returns, sectoral focus and expertise, or volume of required investment.

Selecting the Right Projects

Section 4

Project	Criteria Scores (X/10)							
	Dev. strategy	**Priority sector**	**Basic services**	**S/env impact**	**Trade facilit'n**	**Tech. transfer**	**Return on inv**	**Weighted ave.**
WEIGHT (X/3)	*2*	*3*	*3*	*2*	*1*	*1*	3	
Sewerage	10	10	10	5	0	7		8.0
Gas-run electricity stations	10	10	10	5	0	7		8.0
Housing Falluja	10	10	10	5	0	0		7.5
Renewable energy	10	7	8	5	0	7		6.8
Railways	10	7	6	5	4	7		6.6
Marketing complexes	10	8	8	2	6	0		6.5
Highway B'dad-Turkish border	10	10	6	0	6	3		6.4
Grand Fao Port	10	10	3	0	10	7		6.3
Oil pipelines	10	10	3	0	10	3		6
Oil storage tanks	10	10	3	0	10	0		5.7
Slaughterhouses	0	5	7	2	6	0		3.8
Plane purchases	10	5	0	0	4	3		3.5
Date processing	10	4	0	0	6	0		3.1
Waste recycling	0	3	3	5	0	3		2.5

Thank You for Your Attention!

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www.oecd.org/mena/investment